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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 000471

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STATE FOR NEA/I AND EEB

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TAGS: EPET ENRG ECON PREL I2

SUBJECT: FINE TUNING OUR POSITION ON OIL

REF: LONDON 385

Classified By: Ambassador Ryan C Crocker for reasons 1.4 b,d

¶1. (C) SUMMARY: The Ministry of Oil has announced plans to sign technical service agreements in 2008 with major international oil companies to increase production in its giant oil fields. While comprehensive legislation to protect the interests of foreign companies doing business in Iraq will be necessary before there is significant foreign investment in Iraq's oil sector, these TSAs would be the first significant opening to the private sector since the GOI nationalized oil in 1972. We believe it is in the U.S. interest to encourage this process, especially since early conclusion of TSAs would increase pressure on Iraqi political leaders, in particular the Kurds, to pass national hydrocarbon legislation. END SUMMARY.

¶2. (C) Over the last two years, the Ministry of Oil has entered into several informal arrangements to receive technical services (primarily for training and studies) from major international oil companies (IOCs), on a no-cost basis.

¶3. (C) Subsequently, the Ministry of Oil opened up a pre-qualification window for international oil companies, from January 1, 2008 to February 18, 2008, and signaled its intent to begin a process to sign technical service agreements with IOCs with the goal of increasing production in its giant oil fields. It did not, however, publish the scope of work desired, nor the criteria with which it would judge awarding the TSAs, other than to indicate that any companies that had signed production sharing agreements (PSAs) with the Kurdish Regional Government under the KRG regional hydrocarbon framework law would not be considered.

¶4. (C) The GOI has yet to pass comprehensive legislation to allow for companies to develop hydrocarbon resources on a production sharing basis, or to protect the interests of foreign companies doing so. Nevertheless, the Ministry of Oil and other GoI entities routinely contract for technical expertise from foreign companies, so in principle it should have the legal authority to conclude TSAs with IOCs in the sector.

¶5. (C) We have received some media inquiries about our views on the Oil Ministry's plans to enter into TSAs, given our views on the KRG PSAs, and understand Washington agencies have also been contacted by representatives from some of the major IOCs. We believe we should be strongly supportive of this process, which does not appear to be a step outside Iraq's existing legal framework, unlike the KRG PSAs. TSAs would mark the first significant engagement between Iraq and western IOCs since Iraq completed the nationalization of its

oil sector in 1972. The presence in Iraq of IOCs under TSAs could also help socialize the notion of international involvement in the development of Iraq's oil industry, long subject to ultra-nationalist hype about foreign exploitation.

¶6. (C) Ultimately, to attain levels anywhere near the massive investments projected to rebuild Iraq's energy sector, Iraq still needs to give companies the legal certainty provided by the draft hydrocarbon framework legislation. We believe significant IOC involvement in this round of TSAs can facilitate the effort to obtain movement because it will demonstrate to the Kurds the potential cost of their unilateral approach.

¶7. (C) We propose the following approach:

-- Encourage both the MoO and the IOCs to sign TSAs to improve petroleum production throughout Iraq, especially in the giant and super-giant fields which will most immediately increase production levels;

-- Coordinate with the international community actions that involve high-level engagements to press the KRG and the GOI to reach agreement on the draft hydrocarbon legislation; and,

-- Influence other interested parties, such as the IOCs, to increase pressure on Iraq officials for enactment of the draft hydrocarbon legislation.

¶8. (U) For public affairs purposes, we have shared with NEA/I the following draft press guidance:

Question: Does the USG support the GOI signing TSAs with major IOCs to improve Iraqi oil production?

Answer: The USG position with respect to Iraq's hydrocarbons sector has been clear and consistent. Iraq's oil belongs to

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the Iraqi people, and they will determine, through their elected representatives, how best to marshal those resources for the benefit of the country.

Inviting the IOCs to participate in Iraq's petroleum sector will benefit the Iraqi people. The IOCs can help Iraq increase its oil production by providing technical and management expertise. Increased Iraq oil production will mean increased revenue that the GOI will have at its disposal for infrastructure investment - which enables private sector economic activity - and for the equitable delivery of essential services to all Iraqis. Increased oil production is thus linked to Iraq's ongoing process of economic development and political reconciliation. The United States supports Iraq's efforts to pass new hydrocarbons legislation for these same reasons: such laws will facilitate investment in Iraq's petroleum sector that will in turn benefit the Iraqi people.

Question: Does the GOI's signing these TSAs suggest that new hydrocarbons legislation is unnecessary?

Answer: The United States continues to support the GOI's efforts to pass new hydrocarbons legislation. Iraq's petroleum sector will require billions of dollars in capital investment for the Iraqi people to fully marshal their hydrocarbons resources for the benefit of the country. The GOI has stated repeatedly - and the USG agrees - that providing a clear legal and regulatory framework will facilitate such large scale capital investments. The Iraqi people and their government must determine how best to develop their hydrocarbon resources, but in the absence of new framework legislation there is significant political risk and legal uncertainty. A sound legal structure will help to ensure transparency, provide assurances to investors, attract the best technology, foster sustainable development, and reduce costs.

TSAs are a mechanism for the IOCs to participate in Iraq's

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petroleum sector by providing technical and management expertise to Iraqi counterparts in the oil industry. They are not likely in and of themselves to lead to investment in the sector.

Question: The Kurdish Regional Government (KRG) signed substantial capital production-sharing agreements with smaller IOCs to develop fields in the Kurdish Region. Minister Shahristani has called such agreements "illegal" and stated they are null and void. The United States has said that the KRG's agreements complicated the negotiating environment for passing the new hydrocarbons legislation. Isn't there a double standard? Why hasn't the USG made similar statements about the GOI signing TSAs with IOCs, after suggesting that the KRG's contracts were unhelpful?

Answer: No, there is no double standard. The GOI and the KRG have both consistently stated that the new hydrocarbons legislation will facilitate investment in the petroleum sector and help Iraq develop its natural endowment for the benefit of the Iraqi people. The United States agrees. The United States believes it is in Iraq's interest to pass sound, modern hydrocarbons legislation. The KRG signed production sharing contracts (PSCs) with some international firms.

PSCs provide for exploration and, if commercial discoveries are made, development of hydrocarbons. Such investment commitments are potentially large and long term, which means legal certainty is particularly important. TSAs in contrast are more conventional fee for service arrangements used in many sectors.

We hope the increasing mutually-beneficial involvement of international companies in the oil sector in Iraq will lead to a consensus in favor of sound national legislation. Such a law would permit transparent, competitive consideration of PSA's for hydrocarbon opportunities throughout the country in accordance with Iraq's Constitution, to the benefit of the Iraqi people.

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